

Financial Statements

The Isabella Stewart Gardner Museum, Incorporated, Trustee under the Will of Isabella Stewart Gardner

June 30, 2013 and 2012



Mayer Hoffman McCann P.C.
Tofias New England Division
An Independent CPA Firm

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Financial Statements

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Independent Auditors' Report

To the Trustees of The Isabella Stewart Gardner Museum, Incorporated
Trustee under the Will of Isabella Stewart Gardner
Boston, Massachusetts

We have audited the accompanying financial statements of The Isabella Stewart Gardner Museum, Incorporated, Trustee under the Will of Isabella Stewart Gardner (the "Museum"), which comprise the statements of financial position as of June 30, 2013 and 2012, and the related statements of activities, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Isabella Stewart Gardner Museum, Incorporated, Trustee under the Will of Isabella Stewart Gardner as of June 30, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Mayer Hoffmann McCann P.C.

December 3, 2013
Boston, Massachusetts

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Statements of Financial Position

	<i>June 30,</i>	
	<i>2013</i>	<i>2012</i>
Assets		
Cash and cash equivalents	\$ 3,237,032	\$ 3,588,304
Receivables:		
Pledges receivable, net	6,285,189	9,548,188
Contributions receivable from remainder trusts	2,548,537	2,036,260
Other receivables	1,180,835	1,913,850
Total receivables, net	10,014,561	13,498,298
Prepays, inventory and other assets	1,055,678	868,992
Short-term investments	10,233,707	10,771,003
Museum property:		
Building improvements and other museum property	132,095,863	131,944,264
Construction in progress	577,035	106,804
	132,672,898	132,051,068
Less - accumulated depreciation	(21,549,668)	(15,897,829)
	111,123,230	116,153,239
Historic building, contents and land	4,482,944	4,482,944
Total museum property	115,606,174	120,636,183
Investments of endowed funds	140,189,017	115,423,861
Total assets	\$ 280,336,169	\$ 264,786,641
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses:		
Accrued pension expense	\$ 1,187,605	\$ 834,749
Accounts payable and other accrued expenses	1,805,276	5,964,886
Total accounts payable and accrued expenses	2,992,881	6,799,635
Deferred income	127,821	172,480
Bonds payable	33,560,000	35,000,000
Unamortized premium on bonds payable	887,505	1,037,759
Total liabilities	37,568,207	43,009,874
Net assets:		
Unrestricted	86,955,972	91,898,197
Temporarily restricted	77,079,070	65,107,057
Permanently restricted	78,732,920	64,771,513
Total net assets	242,767,962	221,776,767
Total liabilities and net assets	\$ 280,336,169	\$ 264,786,641

See accompanying notes to the financial statements.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Statement of Activities

Year Ended June 30, 2013

	<i>Operating</i>	<i>Property and Other</i>	<i>Total Unrestricted</i>	<i>Temporarily Restricted</i>	<i>Permanently Restricted</i>	<i>Total</i>
Revenue and other support:						
Admissions	\$ 1,852,762	\$ -	\$ 1,852,762	\$ -	\$ -	\$ 1,852,762
Store	1,004,662	-	1,004,662	-	-	1,004,662
Membership	801,880	-	801,880	-	-	801,880
Rental events	553,463	-	553,463	-	-	553,463
Other earned income	340,316	-	340,316	-	-	340,316
Grants and gifts	813,750	-	813,750	8,820,037	10,018,650	19,652,437
Satisfaction of restricted grants and gifts	1,126,272	2,722,404	3,848,676	(3,848,676)	-	-
Annual appeal	1,832,423	-	1,832,423	-	-	1,832,423
Special events	642,998	-	642,998	-	-	642,998
Investment income and net appreciation	19,510	1,309,202	1,328,712	15,019,474	-	16,348,186
Allocation of endowment income	5,225,000	(477,341)	4,747,659	(4,747,659)	-	-
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Total revenue and other support	14,213,036	3,554,265	17,767,301	15,243,176	10,018,650	43,029,127
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Expenses:						
Security and museum services	2,956,618	-	2,956,618	-	-	2,956,618
Collection, conservation and public programs	4,396,270	-	4,396,270	-	-	4,396,270
Development and external relations	2,255,447	439,416	2,694,863	-	-	2,694,863
Administration	2,603,068	352,856	2,955,924	-	-	2,955,924
Special projects	-	276,156	276,156	-	-	276,156
Facilities and maintenance	1,636,203	-	1,636,203	-	-	1,636,203
Depreciation	200,000	5,451,839	5,651,839	-	-	5,651,839
Interest expense	-	1,470,059	1,470,059	-	-	1,470,059
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total expenses	14,047,606	7,990,326	22,037,932	-	-	22,037,932
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Change in net assets before adjustments	165,430	(4,436,061)	(4,270,631)	15,243,176	10,018,650	20,991,195
Reclassification of net assets	(455,114)	(216,480)	(671,594)	(3,271,163)	3,942,757	-
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total change in net assets	(289,684)	(4,652,541)	(4,942,225)	11,972,013	13,961,407	20,991,195
Net assets, beginning of year	1,778,713	90,119,484	91,898,197	65,107,057	64,771,513	221,776,767
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Net assets, end of year	\$ 1,489,029	\$ 85,466,943	\$ 86,955,972	\$ 77,079,070	\$ 78,732,920	\$ 242,767,962
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See accompanying notes to the financial statements.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Statement of Activities

Year Ended June 30, 2012

	<i>Operating</i>	<i>Property and Other</i>	<i>Total Unrestricted</i>	<i>Temporarily Restricted</i>	<i>Permanently Restricted</i>	<i>Total</i>
Revenue and other support:						
Admissions	1,487,183	\$ -	\$ 1,487,183	\$ -	\$ -	\$ 1,487,183
Store	449,452	-	449,452	-	-	449,452
Membership	841,879	-	841,879	-	-	841,879
Rental events	292,902	-	292,902	-	-	292,902
Other earned income	214,950	-	214,950	-	-	214,950
Grants and gifts	787,650	200,000	987,650	12,250,779	8,412,955	21,651,384
Satisfaction of restricted grants and gifts	857,711	26,113,393	26,971,104	(26,971,104)	-	-
Annual appeal	1,821,267	-	1,821,267	-	-	1,821,267
Special events	811,364	-	811,364	-	-	811,364
Investment income and net appreciation	16,246	(191,630)	(175,384)	(2,356,608)	-	(2,531,992)
Allocation of endowment income	4,772,616	(458,059)	4,314,557	(4,314,557)	-	-
	<u>12,353,220</u>	<u>25,663,704</u>	<u>38,016,924</u>	<u>(21,391,490)</u>	<u>8,412,955</u>	<u>25,038,389</u>
Total revenue and other support						
Expenses:						
Security and museum services	2,211,911	-	2,211,911	-	-	2,211,911
Collection, conservation and public programs	3,733,145	-	3,733,145	-	-	3,733,145
Development and external relations	2,012,946	856,813	2,869,759	-	-	2,869,759
Administration	2,528,898	124,551	2,653,449	-	-	2,653,449
Special projects	-	1,513,483	1,513,483	-	-	1,513,483
Facilities and maintenance	1,371,538	-	1,371,538	-	-	1,371,538
Depreciation	150,000	3,391,352	3,541,352	-	-	3,541,352
Interest expense	-	983,394	983,394	-	-	983,394
	<u>12,008,438</u>	<u>6,869,593</u>	<u>18,878,031</u>	<u>-</u>	<u>-</u>	<u>18,878,031</u>
Total expenses						
Change in net assets before adjustments	344,782	18,794,111	19,138,893	(21,391,490)	8,412,955	6,160,358
Reclassification of net assets	(250,000)	250,000	-	(600,000)	600,000	-
Total change in net assets	94,782	19,044,111	19,138,893	(21,991,490)	9,012,955	6,160,358
Net assets, beginning of year	1,683,931	71,075,373	72,759,304	87,098,547	55,758,558	215,616,409
Net assets, end of year	\$ <u>1,778,713</u>	\$ <u>90,119,484</u>	\$ <u>91,898,197</u>	\$ <u>65,107,057</u>	\$ <u>64,771,513</u>	\$ <u>221,776,767</u>

See accompanying notes to the financial statements.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Statements of Cash Flows

	<i>Years Ended June 30,</i>	
	<i>2013</i>	<i>2012</i>
Cash flows from operating activities:		
Change in net assets	\$ 20,991,195	\$ 6,160,358
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	5,651,839	3,541,352
Contributions and change in value of remainder trusts	(512,277)	22,547
Net realized and unrealized gains on investments	(16,589,559)	2,371,534
Changes in:		
Pledges and other receivables	3,996,014	772,129
Prepays, inventory and other assets	(186,686)	(102,466)
Accounts payable and accrued expenses	(1,862,563)	466,259
Deferred income	(44,659)	169,554
Restricted contributions	(21,811,909)	(22,560,256)
	<u>(10,368,605)</u>	<u>(9,158,989)</u>
Net cash used in operating activities	(10,368,605)	(9,158,989)
Cash flows from investing activities:		
Expenditures for museum property	(2,716,275)	(26,930,840)
Sale of short-term investments	537,296	17,844,487
Purchase of long-term investments	(16,883,801)	(20,853,829)
Redemption of long-term investments	8,708,204	17,648,718
	<u>(10,354,576)</u>	<u>(12,291,464)</u>
Net cash used in investing activities	(10,354,576)	(12,291,464)
Cash flows from financing activities:		
Proceeds from contributions restricted for:		
Endowment	13,990,932	8,403,316
Plant and other	7,820,977	14,156,940
Principal payments on bonds payable	(1,440,000)	-
	<u>20,371,909</u>	<u>22,560,256</u>
Net cash provided by financing activities	20,371,909	22,560,256
Net change in cash and cash equivalents	(351,272)	1,109,803
Cash and cash equivalents, beginning of year	<u>3,588,304</u>	<u>2,478,501</u>
Cash and cash equivalents, end of year	\$ 3,237,032	\$ 3,588,304
Supplemental disclosures:		
Cash paid for interest	<u>\$ 1,627,513</u>	<u>\$ 1,627,513</u>

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 1 - Description of Organization and Summary of Significant Accounting Policies

The Isabella Stewart Gardner Museum, Incorporated (the “Museum”) is the sole trustee under the will of Isabella Stewart Gardner. The Museum owns the property that is located at 280 The Fenway, Boston, Massachusetts, as well as Mrs. Gardner’s art collection contained therein. The Museum Corporation operates the Museum campus which includes a historic building with three floors of artwork, outdoor gardens, and a new wing that opened in January 2012 with purpose-built spaces for visitor accommodation, public programs and administration. The following is a summary of the significant accounting policies of the Museum.

Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis and in accordance with the reporting principles of not-for-profit accounting. Resources are classified into separate net asset classes in accordance with donor-imposed restrictions and legal restrictions under Massachusetts law. The categories unrestricted, temporarily restricted, and permanently restricted net assets are defined as follows:

Unrestricted

Unrestricted net assets are resources over which the Trustees have discretionary control. The Museum records its property and equipment, other than its historical treasures, in this category because there are no time or use restrictions on the use of these assets.

Temporarily Restricted

Temporarily restricted net assets are those resources subject to donor-imposed restrictions which will be satisfied by the actions of the Museum or the passage of time. Appreciation on permanently restricted net assets is recorded in temporarily restricted net assets and may be expended under the terms of the gift instrument or, in the absence of specific terms, in accordance with Massachusetts law.

Permanently Restricted

Permanently restricted net assets are those resources subject to the donor-imposed restriction that they be maintained permanently by the Museum. The donors of these resources require that the principal be invested in perpetuity and permit the income earned, including appreciation, to be used, all or in part, for unrestricted or temporarily restricted purposes. The Museum reports its historical treasures in this category because of their restricted use imposed by the will of Isabella Stewart Gardner.

Fair Value Measurements

The Museum reports certain assets and liabilities at fair value on a recurring and non-recurring basis depending on the underlying accounting policy for the particular item. Recurring fair value measures include the assets under contributions receivable from remainder trust, and both short-term investments and investments of endowed funds. Non-recurring measures include pledges receivable, and the liability netted against the assets under contributions receivable from remainder trusts.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 1 - Description of Organization and Summary of Significant Accounting Policies (Continued)

Fair Value Measurements (Continued)

Fair value standards require an entity to maximize the use of observable inputs (such as quoted market prices in active markets) and minimize the use of unobservable inputs (such as appraisals or other valuation techniques) to determine fair value. The Museum reports certain investments under the so-called “practical expedient” rule, which allows net asset value per share to represent fair value for reporting purposes when the criteria for using this method are met. Fair value standards require the Museum to categorize its financial instruments into a three-level hierarchy based on the priority of inputs to the valuation technique and based on liquidity provisions, as discussed below.

Level 1 – Quoted prices are available in active markets for identical instruments as of the reporting date. Instruments which are generally included in this category include listed equity and debt securities, publicly traded on a stock exchange.

Level 2 – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies. Level 2 assets include investments reported at net asset value per share with withdrawal restrictions of six months or less.

Level 3 – Pricing inputs are unobservable for the instrument and include situations where there is little, if any, market activity for the instrument. The inputs into the determination of fair value require significant management judgment or estimation. Level 3 assets include investments reported at net asset value per share with withdrawal restrictions of more than six months.

In some instances, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such instances, an instrument’s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Market price is affected by a number of factors, including the type of instrument and the characteristics specific to the instrument, as well as the effects of market, interest and credit risk. Instruments with readily available actively quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

It is reasonably possible that different assumptions or changes in values of these instruments could occur which could materially affect amounts reported in these financial statements. For more information on the fair value of the Museum’s financial instruments, see Note 5 - Fair Values of Financial Instruments.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and money market accounts. These assets are stated at cost, which approximates fair value. Cash and cash equivalents held by investment managers are considered part of investment balances. The Museum may hold amounts at a single financial institution in excess of federally insured limits. The Museum monitors its exposure associated with cash and cash equivalents and has not experienced any losses in such accounts.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 1 - Description of Organization and Summary of Significant Accounting Policies (Continued)

Pledges, Grants and Gifts and Annual Funds

Unconditional promises to give are recorded at fair value when initially pledged using a Level 2 fair value approach. Pledges that are expected to be collected in more than one year are recorded at present value using a risk-adjusted rate to account for the inherent risk associated with the expected future cash flows. Amortization of the discount is included in gift and grant revenue. Unconditional promises to give are periodically reviewed to estimate an allowance for doubtful collections. Conditional promises to give are not included as revenue until the conditions are substantially met.

Contributions Receivable from Remainder Trusts

The Museum records the fair value of contributions from remainder trusts upon notification that it has an irrevocable interest in trust assets using a Level 3 fair value approach. The receivable is measured at the present value of estimated future cash flows and recorded presuming a time restriction plus the effects of any further donor restriction. Present values are updated annually for remaining life expectancies using the discount rates set when the contributions were initially recorded.

Inventories

Inventories for the Museum shop are recorded at the lower of average cost or market.

Short-term Investments

Short-term investments are comprised of unspent and undesignated capital campaign funds. These funds consist of cash and money market accounts and are stated at cost, which approximates fair value.

Museum Property

Museum property which existed in 1936 is stated at appraised values established as of December 24, 1936. Subsequent additions are stated at cost. The Museum capitalizes renovations and other additions that materially add to the value of the related assets and extend their useful lives. Equipment and furnishings of relatively small dollar amounts are expensed.

Depreciation of property, plant and equipment is computed using the straight-line method based on estimates of useful lives. The estimated useful lives are principally 10 to 40 years for buildings and improvements and 3 to 10 years for other property. Depreciation for construction in progress begins upon completion of the related project. Fair value of donated fixed assets is effectively recorded using a Level 3 market approach. For more information regarding the Museum's fixed assets, see Note 3 - Fixed Assets.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 1 - Description of Organization and Summary of Significant Accounting Policies (Continued)

Investments

Investments are carried at fair value. Interest, dividends and net gains or losses on investments are reported as increases or decreases in permanently restricted net assets if the terms of the original gift require that they be applied to the principal of a permanent endowment fund; as increases or decreases in temporarily restricted net assets if the terms of the gift and/or relevant state law impose restrictions on the current use of the income or net gains and losses; and as increases or decreases in unrestricted net assets in all other cases. For more information on the fair value of the Museum's investments, see Note 5.

Revenue Recognition

The Museum's revenues from sales and services are recognized when earned which in most cases is when paid for.

Income Taxes

The Museum is recognized by the Internal Revenue Service as an organization described in Section 501(c)(3) of the Internal Revenue Code and is generally exempt from federal and state income taxes on related income. Accordingly, no provision for income taxes is made in the financial statements.

The Museum has determined that its status as a tax exempt entity and its determinations as to its income being related and unrelated are not uncertain tax positions within the meaning of generally accepted accounting principles for its open tax years. The Museum's federal and state income tax returns are generally open for examination for 3 years following the date filed.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant management estimates include reserves for doubtful pledges, discounts on pledges receivable, fair value of certain investments, useful lives of depreciable assets, value of charitable remainder trusts, pension plan assumptions, releases from restriction, and expense allocation by function. Actual results could differ from those estimates.

Subsequent Events

The Museum has evaluated subsequent events through December 3, 2013, the date the financial statements were issued.

Reclassifications

Certain reclassifications have been made to amounts in prior year's financial statements to conform to current year presentation. There is no effect on previously reported net assets.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 2 - Pledges Receivable

Unconditional promises to give (pledges receivable) which are expected to be collected within one year are recorded at their net realizable value. Pledges receivable that are expected to be collected in future years are recorded at the present value of estimated future cash flows, measured at a discount rate of 5%.

The Museum had the following pledges receivable outstanding at June 30:

	<i>2013</i>	<i>2012</i>
Temporarily restricted non-operating support	\$ 6,313,233	\$ 9,455,209
Permanently restricted endowment	430,000	1,044,044
	6,743,233	10,499,253
Less: unamortized discount	(120,882)	(426,102)
Less: allowance for uncollectibles	(337,162)	(524,963)
	\$ 6,285,189	\$ 9,548,188
 Amounts due in:		
Less than one year	\$ 5,123,081	\$ 4,503,371
One to five years	1,620,152	5,995,882
	\$ 6,743,233	\$ 10,499,253

In addition to the unconditional pledges receivable referenced above, the Museum had gross conditional pledges of approximately \$24.5 million and \$33.0 million as of June 30, 2013 and 2012, respectively.

Note 3 - Fixed Assets

In January 2012, the Museum opened to the public a new 70,000 square foot addition to its original building, designed to preserve the historic 1902 structure and alleviate pressures caused by years of use. The new wing includes purpose-built spaces for concerts, exhibitions, and classes, along with enhanced visitor amenities. The structure and contents will be depreciated over periods ranging from 10 to 40 years. Total Museum depreciation expenses in the years ended June 30, 2013 and 2012 were \$5,651,839 and \$3,541,352, respectively. Total capitalized interest in the years ended June 30, 2013 and 2012 were \$0 and \$488,071, respectively.

Note 4 - Investments of Endowed Funds

The Museum's endowed funds are managed by an Investment Committee made up of Trustees with investment experience and with assistance from professional investment consultants. The Museum has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain or enhance the purchasing power of the endowment assets.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 4 - Investments of Endowed Funds (Continued)

The Museum employs external investment managers, with discretion to manage a designated portion of the portfolio to best achieve the investment objectives and requirements of the Museum under guidelines set forth in the Museum's written investment policy statement. The investment portfolio is designed to provide a consistent or enhanced level of support for the Museum's operations, with an average annual real total return (net of investment management fees) of at least 5% over the long term (rolling five-year periods). The Museum believes the investment management fees are comparable to the industry average, however, the fees have not been broken out as some fees are netted by the investment managers against the total investment returns.

To satisfy its long-term rate-of-return objectives, the Museum diversifies its investment portfolio both by asset class (e.g., equities, bonds, cash equivalents, and other alternative investments) and within each asset class (e.g., within equities by economic sector/style, industry, quality, size, etc.). The purpose of diversification is to provide reasonable assurance that no single security or class of securities will have a disproportionate impact on the total portfolio.

The Museum's endowment consists of about 120 individual funds established for a variety of purposes. These funds include both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments.

The Board of Trustees authorized the withdrawal of a portion of the cumulative investment return to support operating activities in the amounts of \$5,225,000 and \$4,772,616 in fiscal years ended June 30, 2013 and 2012, respectively. These amounts represent 5% of the 36-month rolling average market values of endowment funds for which market value exceeded historic cost at the time the withdrawal amount was authorized. The Board has authorized the withdrawal of \$5,785,000 for the fiscal year ending June 30, 2014.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the Museum to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$0 and \$7,105 as of June 30, 2013 and 2012, respectively. The deficiency in 2012 resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted funds.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 4 - Investments of Endowed Funds (Continued)

The change in the Museum's endowment assets was as follows for the years ended June 30:

	2013			
	<i>Unrestricted</i>	<i>Temporarily</i>	<i>Permanently</i>	<i>Total</i>
	<i>Net Assets</i>	<i>Restricted</i>	<i>Restricted</i>	
Endowments at beginning of year	\$ 9,557,083	\$ 48,560,877	\$ 57,417,441	\$ 115,535,401
Gifts and additions	57,911	(55,412)	13,990,932	13,993,431
Net investment return	1,273,864	15,035,071	-	16,308,935
Amounts appropriated under endowment spending policy for operations	(477,341)	(4,747,659)	-	(5,225,000)
Reclassification for endowment losses exceeding corpus	7,105	(7,105)	-	-
Endowments at end of year	\$ <u>10,418,622</u>	\$ <u>58,785,772</u>	\$ <u>71,408,373</u>	\$ <u>140,612,767</u>
Balance due from working capital				(423,750)
Total investments				\$ <u>140,189,017</u>

	2012			
	<i>Unrestricted</i>	<i>Temporarily</i>	<i>Permanently</i>	<i>Total</i>
	<i>Net Assets</i>	<i>Restricted</i>	<i>Restricted</i>	
Endowments at beginning of year	\$ 10,278,910	\$ 55,241,588	\$ 49,014,125	\$ 114,534,623
Gifts and additions	-	-	8,403,316	8,403,316
Net investment return	(257,333)	(2,372,588)	-	(2,629,921)
Amounts appropriated under endowment spending policy for operations	(457,389)	(4,315,228)	-	(4,772,617)
Reclassification for endowment losses exceeding corpus	(7,105)	7,105	-	-
Endowments at end of year	\$ <u>9,557,083</u>	\$ <u>48,560,877</u>	\$ <u>57,417,441</u>	\$ <u>115,535,401</u>
Balance due from working capital				(111,540)
Total investments				\$ <u>115,423,861</u>

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
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Notes to Financial Statements

Note 5 - Fair Values of Financial Instruments

The following tables present financial assets at June 30, 2013 and 2012 that the Museum measures at fair value on a recurring basis, by level within the fair value hierarchy:

	2013			
	<u><i>Level 1</i></u> <u><i>Market</i></u> <u><i>Prices</i></u>	<u><i>Level 2</i></u> <u><i>Observable</i></u> <u><i>Inputs</i></u>	<u><i>Level 3</i></u> <u><i>Management</i></u> <u><i>Judgment</i></u>	<u><i>Total</i></u>
Cash & Cash Equivalents	\$ 14,816,108	\$ -	\$ -	\$ 14,816,108
Fixed Income Funds	3,086,254	-	-	3,086,254
Equities	6,438,518	38,662,199	-	45,100,717
Inflation Hedging	5,527,203	-	-	5,527,203
Marketable Alternatives	-	30,086,570	39,341,779	69,428,349
Non-Marketable Assets	-	-	2,230,386	2,230,386
Total Investments of Endowment Funds	\$ <u>29,868,083</u>	\$ <u>68,748,769</u>	\$ <u>41,572,165</u>	\$ <u>140,189,017</u>
 Short-Term Investments				
Money Market Accounts	\$ <u>10,233,707</u>	\$ -	\$ -	\$ <u>10,233,707</u>
Total Short-term Investments	\$ <u>10,233,707</u>	\$ -	\$ -	\$ <u>10,233,707</u>
 Total Items at Fair Value	 \$ <u>40,101,790</u>	 \$ <u>68,748,769</u>	 \$ <u>41,572,165</u>	 \$ <u>150,422,724</u>
 2012				
	<u><i>Level 1</i></u> <u><i>Market</i></u> <u><i>Prices</i></u>	<u><i>Level 2</i></u> <u><i>Observable</i></u> <u><i>Inputs</i></u>	<u><i>Level 3</i></u> <u><i>Management</i></u> <u><i>Judgment</i></u>	<u><i>Total</i></u>
Cash & Cash Equivalents	\$ 9,430,753	\$ -	\$ -	\$ 9,430,753
Fixed Income Funds	3,080,629	-	-	3,080,629
Equities	3,621,869	31,342,612	-	34,964,481
Inflation Hedging	4,976,767	-	-	4,976,767
Marketable Alternatives	-	30,490,059	29,157,808	59,647,867
Non-Marketable Assets	-	-	3,323,364	3,323,364
Total Investments of Endowment Funds	\$ <u>21,110,018</u>	\$ <u>61,832,671</u>	\$ <u>32,481,172</u>	\$ <u>115,423,861</u>
 Short-Term Investments				
Money Market Accounts	\$ <u>10,771,003</u>	\$ -	\$ -	\$ <u>10,771,003</u>
Total Short-term Investments	\$ <u>10,771,003</u>	\$ -	\$ -	\$ <u>10,771,003</u>
 Total Items at Fair Value	 \$ <u>31,881,021</u>	 \$ <u>61,832,671</u>	 \$ <u>32,481,172</u>	 \$ <u>126,194,864</u>

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Notes to Financial Statements

Note 5 - Fair Values of Financial Instruments (Continued)

The changes in investments measured at fair value for which the Museum used Level 3 inputs to determine the fair value are as follows:

	<i>Equities</i>	<i>Inflation Hedging</i>	<i>Marketable Alternatives</i>	<i>Non- Marketable Assets</i>	<i>Total Level 3</i>
Balance as of July 1, 2011	\$ 33,643	\$ 3,572,805	\$ 15,220,322	\$ 3,505,824	\$ 22,332,594
Net investment gain (loss)	-	-	184,106	95,407	279,513
Transfers from Level 2	-	-	2,219,716	-	2,219,716
Purchases	-	-	8,000,000	-	8,000,000
Redemptions and distributions	(33,643)	(3,572,805)	3,533,664	(277,867)	(350,651)
Balance as of June 30, 2012	<u>-</u>	<u>-</u>	<u>29,157,808</u>	<u>3,323,364</u>	<u>32,481,172</u>
Net investment gain (loss)	-	-	4,476,220	361,461	4,837,681
Transfers from Level 2	-	-	7,961,494	-	7,961,494
Purchases	-	-	5,000,000	-	5,000,000
Redemptions and distributions	-	-	(7,253,743)	(1,454,439)	(8,708,182)
Balance as of June 30, 2013	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 39,341,779</u>	<u>\$ 2,230,386</u>	<u>\$ 41,572,165</u>

Some investment managers maintain “side pockets” or designated illiquid investments, and such funds are reported as Level 3 assets. The net change in value of the “side pockets” is reported as “Transfers from Level 2” in the schedule above. The Museum has no commitments to invest additional funds as of the reporting date.

Management has no intentions or plans to liquidate any NAV practical expedient investments at other than NAV per share.

Under unusual circumstances, fund managers can reserve the right to limit distributions to shareholders; however, the Museum has not experienced any changes or limits over fund distributions.

Management has determined that fair value approximates carrying value for cash and cash equivalents, prepaid assets, other receivables, accounts payable and accrued expenses. Management has no practical or cost effective way of determining fair value for pledges receivable. Fair value of bonds payable is discussed in Note 6 - Bonds Payable.

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Notes to Financial Statements

Note 6 - Bonds Payable

The Museum issued Massachusetts Health and Educational Facilities Authority Revenue Bonds, Series A (2009) in the amount of \$35,000,000. The bonds bear fixed interest rates ranging from 3% to 5%, and at various dates through May 1, 2029. The bonds were issued at a premium of \$1,444,201, which is being amortized over the life of the bonds. Proceeds from the bond issuance are to be expended on (i) construction, furnishing, and equipping of a new museum building, and (ii) interior renovations to the existing museum building. The bonds are secured by all revenues of the Museum.

Bond interest of \$1,620,313 and \$1,627,513 was accrued in the years ended June 30, 2013 and 2012, respectively. Bond premium of \$150,254 and \$152,416 was amortized in the years ended June 30, 2013 and 2012, respectively. Costs of issuance of \$506,515 have been capitalized and are being amortized over the life of the bonds; unamortized bond issuance costs are included in Prepaid and Other Assets.

Scheduled maturities of the bonds are as follows:

2014	\$ 1,485,000
2015	1,525,000
2016	1,590,000
2017	1,650,000
2018	1,730,000
Thereafter	<u>25,580,000</u>
Total bonds payable	\$ <u><u>33,560,000</u></u>

As of June 30, 2013 and 2012, the fair value of the Museum's bonds payable approximated \$36 and \$40 million, respectively, based on quoted market prices for the same or similar issues. The fair value reflects what the Museum would have to pay based on current interest rates and credit position and does not reflect an additional liability to the Museum.

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Notes to Financial Statements

Note 7 - Defined Benefit Plan

The Museum has a defined benefit pension plan which it froze as of June 30, 2006. The Board of Trustees voted to terminate the plan effective December 31, 2012. The Museum has filed the appropriate paperwork with the relevant governing bodies and is awaiting a favorable determination letter from the Internal Revenue Service before commencing the distribution process. Per Pension Benefit Guaranty Corporation (PBGC) guidelines, the termination can be rescinded at any time prior to the commencement of the distribution process. A summary of the funded status of the plan is as follows as of June 30:

	<i>2013</i>	<i>2012</i>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 4,407,203	\$ 3,798,072
Interest cost	185,567	199,195
Benefits paid	(145,074)	(146,652)
Actuarial (gain)/loss	(202,302)	556,588
Benefit obligation at end of year	4,245,394	4,407,203
Change in plan assets:		
Fair value of plan assets at beginning of year	3,572,454	3,087,874
Actual return on plan assets	130,409	231,232
Employer contributions	500,000	400,000
Benefits paid	(145,074)	(146,652)
Fair value of plan assets at end of year	4,057,789	3,572,454
Funded status at end of year	(187,605)	(834,749)
Total pension liability at end of year	\$ (187,605)	\$ (834,749)

The cost of termination is expected to be higher than the pension liability shown above due to regulatory requirements to use different discount rates in valuing the lump sum distributions, as well as the increased cost associated with purchasing annuities for plan participants who do not elect to receive lump sums. The Museum has accrued an additional \$1 million for this anticipated additional liability based on estimates provided by an independent actuary.

The following assumptions were used to determine the benefit obligation at June 30:

	<i>2013</i>	<i>2012</i>
Discount rate	4.75%	4.25%
Expected return on plan assets	5.50%	6.00%

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Notes to Financial Statements

Note 7 - Defined Benefit Plan (Continued)

The operating and non-operating activity reflected in the Administration expense line item in the statement of activities as of June 30, 2013 is comprised of the following Defined Benefit Plan activity:

	<i>Operating</i>	<i>Property and Other</i>	<i>Total</i>
Contributions	\$ 500,000	\$ -	\$ 500,000
Expenses not covered by plan	40,542	-	40,542
FAS adjustment	-	(647,144)	(647,144)
Accrual for termination	-	1,000,000	1,000,000
Total	\$ 540,542	\$ 352,856	\$ 893,398

If the plan is not terminated, the following benefit payments are expected to be paid during the fiscal years ending June 30:

2014	\$ 182,000
2015	212,000
2016	225,000
2017	226,000
2018	230,000
2019-2023	1,309,000

The Museum's plan assets were comprised of the following at June 30:

	<i>2013</i>		<i>2012</i>	
Cash and cash equivalents	\$ 1,410,368	35%	\$ 817,182	23%
Fixed income	2,070,900	51%	2,510,605	70%
Equities	576,521	14%	244,667	7%
Fair value of plan assets	\$ 4,057,789	100%	\$ 3,572,454	100%

All investments held by the plan at June 30, 2013 and 2012 were Level 1 assets.

Note 8 - Defined Contribution Plan

The Museum has a 403(b) retirement plan in which eligible employees may invest a portion of their compensation. Eligibility is based on the length of service. Employer contributions into the plan on behalf of eligible employees are discretionary and vest over a two year period. Employer contributions made under this plan totaled \$206,652 and \$201,420 during fiscal years ended June 30, 2013 and 2012, respectively.

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Notes to Financial Statements

Note 9 - Net Assets

Temporarily restricted net assets include the following categories as of June 30:

	<i>2013</i>	<i>2012</i>
Accumulated unspent gains on endowments:		
Collection conservation and building preservation	\$ 3,970,802	\$ 1,674,816
Curatorial programs	4,890,172	3,458,784
Music, contemporary, and horticulture programs	2,013,536	1,039,665
Education and other public programs	2,243,172	1,559,438
Undesignated and other purposes	<u>45,668,090</u>	<u>40,260,462</u>
Total unspent gains on endowments (subject to Trustee appropriation)	58,785,772	47,993,165
Gifts and grants designated for operating activities	1,772,668	1,528,644
Gifts and grants designated for non-operating activities	10,528,507	6,871,929
Pledges receivable and charitable remainder trusts	<u>5,992,123</u>	<u>8,713,320</u>
 Temporarily restricted net assets	 <u>\$ 77,079,070</u>	 <u>\$ 65,107,057</u>

Permanently restricted net assets are restricted as follows as of June 30:

	<i>2013</i>	<i>2012</i>
Endowed assets designated for the following purposes:		
Collection conservation and building preservation	\$ 21,899,869	\$ 14,316,819
Curatorial programs	15,099,619	14,941,994
Music, contemporary, and horticulture programs	9,619,623	3,569,366
Education and other public programs	6,373,611	6,173,611
Undesignated and other purposes	<u>18,415,651</u>	<u>18,415,651</u>
Investment in perpetuity, the income from which is expendable (with appreciation recorded as temporarily restricted)	71,408,373	57,417,441
Pledges receivable and charitable remainder trusts	2,841,603	2,871,128
Historical treasures	<u>4,482,944</u>	<u>4,482,944</u>
 Permanently restricted net assets	 <u>\$ 78,732,920</u>	 <u>\$ 64,771,513</u>

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Notes to Financial Statements

Note 10 - Restrictions on Operating Surplus

The Trustees are directed, under the will of Isabella Stewart Gardner, to pay to certain designated hospitals any surplus of income that, in the opinion of the Director and Trustees, will not be needed for the proper and reasonable maintenance of the Museum. These amounts, if any, are payable at the end of successive five-year periods, the most recent of which ended on December 31, 2009. The Trustees have determined that excesses, if any, are needed for the proper and reasonable maintenance of the Museum.

Note 11 - Functional Expenses

The following summarizes the functional expenses for the year ended June 30:

	<i>2013</i>	<i>2012</i>
Museum programs	\$ 18,316,369	\$ 15,202,627
Management and general	1,632,839	1,334,469
Fundraising	<u>2,088,724</u>	<u>2,340,935</u>
	<u>\$ 22,037,932</u>	<u>\$ 18,878,031</u>

The above functional expense classifications reflect the ongoing programs of the Museum. Certain expenses such as employee benefits, depreciation, security, and building operations have been allocated to the functions identified above. Methods used in allocating these expenses include actual expenses incurred and proportional percentage allocation.

Note 12 - Commitments and Contingencies

As of June 30, 2013, the Museum was unable to estimate the range of settlement dates and the related probabilities for certain asbestos remediation Asset Retirement Obligations (AROs). These conditional AROs are primarily related to the encapsulated structural fireproofing that is not subject to abatement unless the buildings are demolished and non-encapsulated asbestos that the Museum would remediate only if it performed major renovations of certain existing buildings. Because these conditional obligations have indeterminate settlement dates, the Museum could not develop a reasonable estimate of their fair values. The Museum will continue to assess its ability to estimate fair values at each future reporting date. The related liability will be recognized once sufficient additional information becomes available.